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FEDERAL COMMUNICATIONS COMMISSION
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RochesterTel

July 30, 1992

BY OVERNIGHT MAIL

Ms. Donna R. Searcy
Secretary
Federal Communications Commission
1919 M Street, N. W.
Washington, D. C. 20554

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JUL 31 1992

FCC MAIL BRANCH

Re: CC Docket No. 92-101

Dear Ms. Searcy:

Enclosed for filing please find an original plus seven (7) copies of the Rebuttal To Oppositions To Direct Case of Rochester Telephone Corporation in this proceeding.

To acknowledge receipt, please affix an appropriate notation to the copy of this letter provided herewith for that purpose and return same to the undersigned in the enclosed self-addressed envelope.

Very truly yours,

Michael J. Shortley, III

cc: Downtown Copy Center

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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OFFICE OF THE SECRETARY

In the Matter of	
Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers Accounting for Post-Retirement Benefits Other Than Pensions"	CC Docket No. 92-101

REBUTTAL TO OPPOSITIONS TO DIRECT CASE OF ROCHESTER TELEPHONE CORPORATION

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JOSEPHINE S. TRUBEK
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July 30, 1992

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Before the
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Washington, D.C. 20554

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REBUTTAL TO OPPOSITIONS TO DIRECT CASE
OF ROCHESTER TELEPHONE CORPORATION

Introduction and Summary

Rochester Telephone Corporation, on its behalf, that of its exchange carrier subsidiaries that concur in its Tariff F.C.C. No. 1[1/] and that of Vista Telephone Company of Iowa and

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1/ AuSable Valley Telephone Company, Inc., Breezewood Telephone Company, C, C & S Telco, Inc., Canton Telephone Company, Enterprise Telephone Company, Highland Telephone Company, Inland Telephone Company, Lakeshore Telephone Company, Lakeside Telephone Company, Lakewood Telephone Company, Midland Telephone Company, Midway Telephone Company, Mondovi Telephone Company, Monroeville Telephone Company, Inc., Mt. Pulaski Telephone & Electric Company, Ontonagon County Telephone Company, Orion Telephone Exchange Association, Oswayo River Telephone Company, Prairie Telephone Company, S & A Telephone Company, Inc., The Schuyler Telephone Company, Seneca-Gorham Telephone Corporation, Southland Telephone Company, Sylvan Lake Telephone Company, Inc., The Thorntown Telephone Company, Inc. and Urban Telephone Corporation.

Vista Telephone Company of Minnesota (collectively referred to as "Rochester"), hereby submits this Rebuttal to the Oppositions[2/] to its Direct Case submitted in response to the Bureau's Designation Order.[3/]

In its Opposition, AT&T recognizes that the expense associated with the implementation of Statement of Financial Accounting Standards ("SFAS") 106 qualifies for exogenous cost treatment under price cap regulation.[4/] The remaining opponents claim that none of the expense associated with accrual accounting for Other Post-Employment Benefits ("OPEBs") so qualifies.[5/] All opponents contend that, if the Commission accords exogenous cost treatment to the implementation of SFAS 106, the magnitude of the adjustments claimed by the price

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2/ Rochester has received Oppositions filed by American Telephone & Telegraph Company ("AT&T"); MCI Telecommunications Corporation ("MCI"); Ad Hoc Telecommunications Users Committee ("Ad Hoc"); and International Communications Association ("ICA"). In this Rebuttal, Rochester will cite to those Oppositions in the form "_____ Opposition at ____." Similarly, it will cite to its Direct Case as "Rochester Direct Case at ____."

3/ Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers Accounting for Post-Retirement Benefits Other Than Pensions," CC Dkt. 92-101, Order of Suspension and Investigation, 7 F.C.C. Rcd. 2724 (Com. Car. Bur. 1992).

4/ AT&T Opposition at 5-6, App. C at 6.

5/ MCI Opposition at 5-10; Ad Hoc Opposition at 5; ICA Opposition at 2.

cap exchange carriers is vastly overstated.[6/] As Rochester demonstrates herein, these claims lack merit.

First, the expense increase resulting from the implementation of SFAS 106 qualifies, under the plain words of the Commission's rules,[7/] as exogenous. The adoption of the accounting statement was not within Rochester's control[8/] and will cause Rochester to recognize an increase in expense on its income statement and an associated increase in liability on its balance sheet. Under the Commission's definition of exogenous costs,[9/] mandatory implementation of SFAS 106 plainly qualifies.

Moreover, the claim that recognition of the incremental SFAS 106 expense as exogenous would contravene fundamental

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6/ As Rochester noted in its Direct Case (Rochester Direct Case at 30), the figures that it submitted are its best current estimates of the amount of the exogenous cost adjustment it may ultimately seek.

7/ See 47 C.F.R. § 61.45(d)(1)(ii) (1991).

8/ See Southwestern Bell, GTE Corporation: Notification of Intent to Adopt Statement of Financial Accounting Standards No. 106, Employer's Accounting for Postretirement Benefits Other than Pensions, AAD 91-80, Order (Dec. 26, 1991).

9/ See Policy and Rules Concerning Rates for Dominant Carriers, CC Dkt. 87-313, Second Report and Order, 5 F.C.C. Rcd. 6786, 6807, ¶ 166 (1990) ("Second Report and Order").

principles of price cap regulation[10/] is spurious. These arguments rely upon analogies to the endogenous treatment of equal access and depreciation expenses under price caps. Those analogies are inapplicable. Rochester is not requesting exogenous treatment of its OPEB expense. Rather, it is requesting exogenous treatment of the incremental increase in costs that it must now recognize as a result of the implementation of SFAS 106.[11/] It is precisely this amount that would have been embedded in Rochester's initial price cap rates had SFAS 106 been mandated prior to the initiation of price caps.

In addition, MCI's claim[12/] that the lower end adjustment is an adequate backstop should be rejected. The treatment of certain costs as exogenous and the lower end and sharing

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10/ E.g., MCI Opposition at 8-10; Ad Hoc Opposition at 5-18.

11/ Rochester Direct Case at 24 n.31; see also National Economic Research Associates, Inc., The Treatment of FAS 106 Accounting Changes Under Price Cap Regulation at 17-18 (April 15, 1992), Pacific Bell, Tariff F.C.C. No. 128, Trans. 1379, Description & Justification, Section VI (April 16, 1992) ("NERA Study").

In its Direct Case, Rochester relied upon the NERA Study as the basis for exogenous cost treatment of its SFAS 106 expense. Rochester continues to so rely.

12/ MCI Opposition at 23-24.

mechanisms exist coterminously. The Commission did not intend one to displace the other.[13/]

Second, some opponents correctly recognize that implementation of SFAS 106 merely represents an accounting change, not an increase in the true economic costs of employee compensation. This conclusion is correct. However, the opponents incorrectly suggest that, as a result, no exogenous adjustment is warranted.[14/] As the NERA Study demonstrates, accrual accounting for OPEBs represents the best estimate of their true economic costs. Regulated firms, unlike their counterparts in sectors of the economy that are not price regulated, have been able to reflect only the accounting costs of OPEBs in their prices. According exogenous cost treatment to incremental SFAS 106 expense would simply place exchange carriers on an equal footing with unregulated companies.[15/]

Moreover, the claim that SFAS 106 affected the prescribed rate of return for price cap regulated exchange carriers[16/] is not correct. That assertion depends, as it must, upon a set of tenuous and unsupported assumptions regarding investor expectations at the time of the last rate of return

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13/ Rochester Direct Case at 22.

14/ E.g., MCI Opposition at 7-8.

15/ NERA Study at 17-18.

16/ MCI Opposition at 11-17.

represcription. This claim also assumes that a purported drop in stock prices associated with the adoption of SFAS 106 was caused by an increase in the cost of capital. To the extent that such a change in stock prices did occur, this argument conveniently ignores a much more rational cause -- investor expectations regarding growth in earnings or dividend payments changed. There is no fundamental or theoretical basis for the conclusion that the adoption of SFAS 106 changed, in any way, the underlying riskiness and, therefore, the cost of capital of firms that provide OPEBs.

Third, the claims that a substantial portion of the increased accounting expense is, or will be, recognized in GNP-PI[17/] is wrong. Because SFAS 106 will not increase the economic cost of OPEBs, the claim that future medical cost inflation is embedded in GNP-PI is irrelevant. The further claims that the Commission should mandate uniform actuarial assumptions or impose caps on expense recognition should be rejected.[18/] The assumptions adopted by individual companies are unique to their own plans and, although those assumptions vary, there is no reason to conclude that any are unreasonable. In addition, the request that only prefunded OPEB amounts be recognized[19/] should be rejected. SFAS 106

17/ AT&T Opposition at 4-5; Ad Hoc Opposition at 19-24.

18/ See, e.g., AT&T Opposition at 27-29.

19/ Id. at 14-16.

requires current period recognition of accrual expenses, even if effective funding vehicles are unavailable. As with any other accrual expense, recognition and funding are wholly independent events. The Commission should treat them as such.

The opponents fail to demonstrate that the expense Rochester will incur in implementing SFAS 106 does not qualify for exogenous cost treatment.

Argument

I. COSTS ASSOCIATED WITH IMPLEMENTATION OF SFAS 106 QUALIFY FOR EXOGENOUS COST TREATMENT UNDER PRICE CAPS.

The Commission's rules plainly contemplate that costs associated with a change in accounting rules qualify for exogenous cost treatment. AT&T accepts this basic proposition.[20/] The other opponents claim that such treatment is inconsistent with basic principles of price cap regulation. Fundamental theories of price cap regulation demonstrate that, as to qualification of SFAS 106 expense for exogenous cost treatment, AT&T is correct.

A. SFAS 106 Expense Qualifies for Exogenous Cost Treatment.

Under the Commission's price cap rules, costs (or savings) resulting from changes in legislative, judicial or administrative decisions that are beyond a carrier's control qualify for exogenous cost treatment. Indeed, the Commission's rules recognize that changes in Generally Accepted Accounting

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20/ Id. at 5-6.

Principles ("GAAP"), to the extent not otherwise reflected in GNP-PI, deserve exogenous cost treatment.[21/] None of the opponents deny this general proposition.[22/] Thus, on its face, the implementation of SFAS 106 qualifies for exogenous treatment.

B. Claims That Exogenous Cost Recognition Will Dilute Price Cap Incentives Lack Merit.

Ad Hoc and MCI claim that recognition of SFAS 106 expense as exogenous would be inconsistent with the principles underlying price cap regulation. They assert that, because exchange carriers have control over their OPEB expense, just as they do any other form of employee compensation, affording exogenous cost treatment to that expense would eliminate any incentive that exchange carriers would otherwise have to manage their OPEB expense.[23/] In this regard, they claim that OPEB expense is analogous to depreciation or equal access expenses,

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21/ See 47 C.F.R. § 61.45(d)(1)(ii) (1991).

22/ Ad Hoc also claims that accounting changes were not accorded exogenous treatment automatically. Ad Hoc Opposition at 5-7. Ad Hoc is only partially correct. Changes in GAAP that are not reflected economy-wide qualify; changes that are reflected economy-wide do not qualify. Thus, Ad Hoc's claim goes only to the amount of the exogenous cost adjustment, not to its propriety.

23/ E.g., MCI Opposition at 6-10.

which the Commission chose to treat as endogenous.[24/]

This analysis misses the point. Rochester is not asking for recognition of its OPEB expense as exogenous. Rather, it is requesting exogenous cost treatment for the incremental increase in its OPEB expense that will result from implementation of SFAS 106. Exchange carriers plainly exercise control over the level of employee compensation. What is beyond their control is the Commission-mandated change from cash to accrual accounting for OPEBs. A one-time exogenous cost adjustment to reflect this accounting change is appropriate.

Indeed, the opponents assume that the Commission will need to evaluate continuously the reasonableness of exchange carriers' OPEB expenses, thus reintroducing rate of return regulation on a piecemeal basis.[25/] That, however, is not the case. As NERA demonstrated, a one-time adjustment to the price cap indices is necessary to reflect the true economic costs of OPEBs. Such an adjustment would provide exchange carriers with

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24/ See Ad Hoc Opposition at 13-17.

25/ Ad Hoc Opposition at 16; MCI Opposition at 11 n.14.

MCI makes the curious claim that all forms of employee compensation are intertwined and, therefore, it is not possible to treat some forms of employee compensation (wages and pensions) as endogenous and other forms (OPEBs) as exogenous. MCI Opposition at 6-7. That, of course, is not what Rochester is proposing.

the opportunity to establish prices that reflect economic costs. It would also reduce the intergenerational inequity embedded in current rates by recognizing that the promise to pay OPEBs is a current cost which should be borne by today's, rather than tomorrow's, ratepayers.[26/]

After recognition of this accounting change, exchange carriers would, on an ongoing basis, have every incentive to manage their OPEB expense, just as they would any other type of expense.[27/] Thus, all of the efficiency generating incentives of price cap regulation will apply to OPEB expense, other employee compensation expense and any other cost of doing business. A one-time exogenous cost recognition for the implementation of SFAS 106 is compelled by the theory of price cap regulation.

Contrary to the opponents' claims, OPEB expense would not be subject to the type of manipulation that caused the Commission to refuse to accord exogenous cost treatment to depreciation and equal access expenses. The Commission concluded that affording exogenous cost treatment to those expenses would create incentives for exchange carriers improperly to manipulate their level and timing. Such

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26/ NERA Study at 17-18.

27/ E.g., Rochester Direct Case at 24 n.31.

treatment would also have embroiled the Commission in a continuous reevaluation of exchange carriers' depreciation and equal access expenses.[28/] Unlike the proposals affecting depreciation and equal access expenses, Rochester is not proposing that OPEB expense per se be accorded exogenous cost treatment. Rather, it is proposing only a one-time adjustment that reflects the incremental change in OPEB expense caused by the decision to mandate use of the new accounting standard. Under this approach, there is no incentive to manipulate OPEB expense in the future. Rather, exchange carriers will have the same incentive to manage OPEB expense that they do with every other cost of doing business.

Finally, the Commission should reject MCI's argument that the existence of the lower end adjustment renders exogenous cost treatment unnecessary.[29/] As Rochester demonstrated,[30/] the lower end (and sharing) mechanisms and the exogenous cost rules were adopted simultaneously. The Commission did not intend one set of adjustments to displace the other. Yet, adoption of MCI's request would cause this result.

28/ Second Report and Order, 5 F.C.C. Rcd. at 6808-09, ¶¶ 180-87.

29/ MCI Opposition at 23-24.

30/ Rochester Direct Case at 22.

The lower end and sharing mechanisms, on the one hand, and the exogenous cost rules, on the other, were designed to address very different concerns. The Commission adopted the lower end and sharing mechanisms to take into account the possibility that the industry-wide productivity offsets that it selected may not be appropriate for an individual exchange carrier.[31/] One carrier's productivity may be sufficiently far from the average that, in the absence of the lower end and sharing mechanisms, that carrier may realize either an inequitably low or high return.

The exogenous cost rules address an entirely different set of concerns. Price cap regulation provides carriers with strong incentives to take actions such as managing expenses, introducing new services and improving service quality. The exogenous cost rules address situations where changes in costs are not within a carrier's control. If a particular cost change -- either positive or negative -- is outside an exchange carrier's control, the theory of price cap regulation appropriately requires that an exchange carrier neither benefit from nor be burdened by that cost change. MCI's analysis ignores this basic principle.

31/ Second Report and Order, 5 F.C.C. Rcd. at 6801, ¶¶ 120-29.

II. THAT SFAS 106 IS AN ACCOUNTING CHANGE IS IRRELEVANT TO ITS QUALIFICATION FOR EXOGENOUS COST TREATMENT.

Ad Hoc notes that the accounting change mandated by SFAS 106 will not change any economic costs of doing business. From this, it concludes that, because other firms will not be able to recognize SFAS 106 expenses in their prices, the Commission should decline to provide exchange carriers with this opportunity.[32/] MCI makes the related claim that the implementation of SFAS 106 was a known event and is therefore embedded in the cost of capital prescribed by the Commission.[33/] Both claims lack merit.

A. Unregulated Companies Have Already Recognized SFAS 106 in Prices.

Ad Hoc contends that, because the implementation of SFAS 106 will not change any economic costs of doing business, it is inequitable that interstate access customers face price increases to accommodate an accounting change. AT&T also makes the related claim that unregulated companies have not fully reflected in their prices the effects of SFAS 106 and, therefore, regulated companies should not be permitted to do so either. These assertions are incorrect.

It is undisputed that pricing decisions in sectors of the economy that are not price regulated are based upon economic,

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32/ Ad Hoc Opposition, App. I (D. Roddy and P. Montgomery, Analysis of FAS 106 Effects Under Price Caps) at 2.

33/ MCI Opposition at 11-17.

not accounting, costs.[34/] It is also true that pay-as-you-go accounting does not reflect the economic costs of OPEBs. A promise today to pay OPEBs is a part of an employee's current compensation and, therefore, is a current cost of doing business. Since firms in unregulated sectors of the economy price their goods and services on the basis of economic costs, those prices already implicitly reflect accrual accounting for OPEBs.[35/] Thus, in direct contrast to Ad Hoc's assertion that unregulated firms will be unable to reflect SFAS 106 in their prices, they have already done so.

AT&T claims that non-regulated firms, in fact, have not reflected accrual accounting for OPEBs in their prices.[36/] AT&T's approach is misguided. The best estimate of the cost of offering OPEBs is the present value of the future stream of benefits being promised. That present value is precisely what SFAS 106 is intended to capture. While AT&T may be correct that SFAS 106 is not intended to be a pricing guide,[37/] the observation misses the point. SFAS 106, because it reflects accrual accounting, represents the best estimate of the economic costs of providing OPEBs. Again, although AT&T is correct that SFAS 106 forbids companies from taking into

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34/ E.g., NERA Study at 17-18.

35/ Id.

36/ AT&T Opposition, App. C at 3-5.

37/ Id. at 3.

account possible future events, such as national health insurance,[38] that restriction should have no effect on an estimate today of the present value of the future stream of payments for OPEBs. As such, AT&T's conclusion that unregulated firms have not reflected OPEBs in their prices is incorrect.

Regulated firms, on the other hand, have been confined by regulation to reflecting only accounting costs in their rates.[39] Recognition of the implementation of SFAS 106 as exogenous would merely place regulated firms on the same footing as their unregulated counterparts. Moreover, as noted above, according exogenous treatment to the implementation of SFAS 106 will result in a more economically efficient set of prices and promote intergenerational equity.[40] The claim that recognizing the implementation of SFAS 106 as exogenous is somehow unfair or inequitable should be rejected.

B. MCI's Claim That the Implementation of SFAS 106 Is Fully Reflected in the Existing Rate of Return Is Incorrect.

MCI contends that, when the Commission last prescribed the authorized rate of return for exchange carriers, the implementation of SFAS 106 was a known event. Therefore, its effect on book earnings was fully taken into account in the

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38/ Id.

39/ E.g., Rochester Direct Case at 14-15.

40/ See supra at 9-10.

prescription of the authorized return of 11.25%.[41/] As MCI obliquely acknowledges, for its theory to make sense in the context of a regulated industry,[42/] investors must have expected that the regulators would not permit rate recovery of this increased book expense. Otherwise, there would be no reason for investors to discount exchange carriers' stock prices.

The contention that, at the time of the last represcription, investors would have expected rate relief to be denied is not tenable. During 1989 and the first half of 1990, when the represcription proceeding was taking place, the entire exchange carrier industry was subject to cost of service regulation. Under that form of regulation, the expense increase occasioned by the implementation of SFAS 106 would typically be recognized for ratemaking purposes. Indeed, in its 1990 Annual Access Tariff Order,[43/] the Commission had begun to recognize certain types of costs being incurred in connection with the implementation of SFAS 106 -- e.g., the funding of Voluntary Employee Benefit Association trusts -- for ratemaking purposes. Moreover, in its 1992 Annual Access

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41/ MCI Opposition at 11-17.

42/ Id. at 11-14.

43/ Annual 1990 Access Tariff Filings, 5 F.C.C. Rcd. 4177, 4211-12, ¶¶ 305-10 (Com. Car. Bur. 1990).

Tariff Order,[44/] the Commission permitted cost of service companies to recognize SFAS 106 expense in rates, thus confirming the general expectation that regulated companies would generally have been permitted to recover their SFAS 106 expense.

When the represcription process was ongoing, the implementation of price cap regulation was a known fact. However, the price cap rules that the Commission was considering permitted exogenous cost treatment for mandatory accounting changes.[45/] Under these circumstances, it would have been reasonable, and probably likely, that investors anticipated that the Commission would permit exchange carriers to recover the increased expense associated with implementation of SFAS 106.

In addition, the studies of the effect on stock prices from the implementation of SFAS 106 cited by MCI's expert, Professor Drazen,[46/] should be disregarded in this proceeding. Messrs. Mittelstaedt and Warshawsky -- the authors of the studies -- excluded regulated industries from their

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44/ 1992 Annual Access Tariff Filings, CC Dkt. 92-141, Memorandum Opinion and Order, DA 92-841, ¶¶ 70-71 (Com. Car. Bur. June 22, 1992).

45/ See supra at 7-8.

46/ MCI Opposition, App. A (Affidavit of Allen Drazen), ¶ 7.

analysis.[47/] Thus, even if investors discounted the effects of implementation of SFAS 106 on unregulated firms, there is no reason to believe that they did so for regulated firms.

Finally, even if investors discounted the price of exchange carriers' stocks in response to the implementation of SFAS 106, there is no evidence to support MCI's assertion that this resulted from a change in the cost of capital. Indeed, there is every reason to believe that it did not. The adoption of SFAS 106 did not introduce any fundamental change in the economy or in the riskiness of any particular company. Its adoption merely changed accounting rules so that companies are now required to recognize certain expenses and liabilities earlier than they otherwise would on their financial reports. Thus, there is no reason to assume that the adoption of SFAS 106 had any effect on any exchange carrier's cost of capital.

The discounted cash flow model, which the Commission utilized and upon which MCI relies, contains a number of inputs. In the model, the cost of capital depends upon not only a firm's stock price, but also its dividend payments and investor expectations regarding growth. MCI asserts, without support, that a change in stock prices was caused by a change

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47/ H. Middlestaedt and M. Warshawsky, The Impact of Liabilities for Retiree Health Benefits on Share Prices, Finance and Economics Discussion Series Paper 156 at 14 (Federal Reserve Board April 1991).

in risk. However, assuming that investors reflected SFAS 106 in stock prices, they likely did so, not because of any change in risk and, hence, the cost of capital, but rather because expectations about growth in earnings and dividends changed. As a result of SFAS 106, investors are being provided with more information regarding companies' OPEB liabilities than they previously possessed. This new information may have caused investors to revise downward their expectations regarding growth in earnings and dividends. Such a change in expectations would also have had a depressing effect on stock prices, yet it would not have resulted from a change in a firm's cost of capital.

MCI merely assumes, but does not prove, the existence of a causal link between changes in stock prices and changes in the cost of capital. The existence of such a link is unsupported and inconsistent with the notion that the adoption of SFAS 106 may have lowered investor expectations regarding future levels of earnings and dividends.

III. THE IMPLEMENTATION OF SFAS 106 WILL BE REFLECTED ONLY MINIMALLY IN GNP-PI.

In its Direct Case, Rochester demonstrated that only 4.2% of its incremental OPEB expense would be reflected in GNP-PI and that the remaining 95.8% qualifies for exogenous cost treatment.[48/] The opponents argue that, because medical care inflation and GNP-PI are interrelated, exchange carriers are

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48/ Rochester Direct Case at 20.

understating the amount of OPEB expense that will be reflected in GNP-PI.[49/]

AT&T and MCI further claim that the NERA Study's conclusion that prices would rise only in the regulated and cost plus sectors of the economy is purely a "back of the envelope" calculation and ignores any second order effects of those price increases on prices in other sectors of the economy.[50/] Ad Hoc joins in this claim.[51/] Finally, AT&T takes issue with NERA's conclusion that only rate regulated and cost plus firms will include SFAS 106 expense increases in prices.[52/] These claims lack merit and the Commission, therefore, should decline to adopt the various "remedies" -- such as mandating the use of uniform actuarial and capping assumptions and recognizing only OPEB expenses that are actually funded -- suggested in the Oppositions.

49/ E.g., AT&T Opposition at 7-8.

50/ AT&T Opposition, App. C at 6; MCI Opposition at 21-22.

51/ Ad Hoc Opposition at 22-23.

52/ AT&T Opposition, App. C at 2-5.

In advancing this argument, AT&T concedes that Rochester should recover at least 69% of its incremental SFAS 106 expense in rates. Id. at 6. AT&T's quarrel is merely with the amount of the expense increase that should qualify for exogenous treatment, rather than with the propriety of that treatment itself.

A. That Health Care Inflation Is a Component of GNP-PI Does Not Result in the Claimed Double Count.

MCI mistakenly asserts that, because health care inflation is a component of GNP-PI, the failure to remove that component from GNP-PI would result in a double recovery of OPEB expense.[53/] There is a fundamental error in this logic, namely, that the implementation of SFAS 106 will have any effect on health care costs. As Rochester demonstrated,[54/] the implementation of SFAS 106 is an accounting change only. Its implementation will not change any economic costs. Indeed, implementation of SFAS 106 will have absolutely no effect on the cost of providing medical care and, therefore, will not affect the price for medical care. As such, the implementation of SFAS 106 -- the event for which exogenous cost treatment is being requested[55/] -- will not affect GNP-PI through changes to its medical cost component. Thus, the assumption that the implementation of SFAS 106 will affect the health care

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53/ MCI Opposition at 30-31.

54/ See Rochester Direct Case at 14-15, 24 n.31.

55/ See supra at 9.

component of GNP-PI is wrong.[56/]

AT&T, for its part, takes the opposite tack. It asserts that a double count exists because GNP-PI is embedded in medical care inflation.[57/] This assertion also lacks merit. While GNP-PI may be embedded in medical care inflation, it is also embedded in the discount rate. The medical care trend rate is used to project future cash outlays necessary to provide OPEBs. The medical care trend rate includes, as one of its components, general inflation. However, exchange carriers must discount that stream of cash outlays to determine their present value, upon which the OPEB accrual is based. The discount rate also reflects, and thus effectively removes, general inflation in establishing the OPEB accrual. As such, the alleged double count does not exist.

56/ In this respect, the implementation of SFAS 106 is identical to the expiration of a reserve deficiency amortization. Both change book, but not economic, costs and both affect types of expenses that are components of GNP-PI. No party, however, has contended that the recognition of the expiration of a reserve deficiency amortization -- which results in a negative exogenous cost change -- should be eliminated to account for any potential double count. The same result is conceptually correct for SFAS 106 expenses.

Ad Hoc takes issue with this analysis, by contending that ratepayers should benefit from the reduction in book expense caused by the expiration of a reserve deficiency amortization. Ad Hoc Opposition at 18 n.46. Ad Hoc's analysis simply ignores the symmetrical nature, up or down, of expense changes that qualify for exogenous cost treatment.

57/ AT&T Opposition at 12-14.